

**A United Overseas Bank Ltd v Ketua Pengarah Hasil
Dalam Negeri**

HIGH COURT (KUALA LUMPUR) — TAX APPEAL NO R1-14-7-1996
ABDUL KADIR SULAIMAN J
2 JUNE 1997

B *Revenue Law — Income tax — Additional assessment — Paid income tax on interest income received from branch in Malaysia but was issued notices of additional assessment requesting payment in respect of same interest income — Whether interest charges constituted business expense to branch and business income to head office — Whether subject to tax*

C
D
E
F
G
The appellant was carrying on banking business in Singapore. The appellant carried on the banking business in Malaysia through a branch in Kota Kinabalu, Sabah. The appellant, through its head office in Singapore, had duly paid the relevant taxes in Singapore for the interest charged on the sum made available to its Malaysian branch. However, the respondent also issued notices of additional assessment requesting payment from the appellant in respect of the same interest income. The appellant objected to this additional tax imposed on the interest income and appealed to the Special Commissioner. The appellant based their objection on the grounds that the interest charges imposed on its branch in Malaysia constituted business expense to the branch and a business income to the head office; and that by reason of arts IV and XV of the Double Taxation Relief (Singapore) Order 1968 ('the 1968 Order'), the said interest received would not be subject to any tax as interest income and further that there could be no economic or commercial link between the head office and the branch in the provision of funds for which the latter was required to pay the interest on the fund provided. The Special Commissioner dismissed the appeal and concluded that the interest received by the appellant was part of the appellant's income in Malaysia on which Malaysian tax may be imposed in accordance with art IV of the agreement in the Schedule to the 1968 Order. Thus, the appeal came to the court. The question posed for the court was whether on the facts found by the Special Commissioner, their decision was correct in law.

H **Held**, allowing the appeal:

- I**
- (1) By s 132(1) of the Income Tax Act 1967 ('the Act'), 'a place of priority and pre-eminence must be given to the agreement' in the 1968 Order over domestic or municipal law. Unilateral legislation must give way to the agreement which becomes municipal law. In the event of conflict, the provisions of the 1968 Order should prevail (see p 364C-G); *Ostime (HM Inspector of Taxes) v Australian Mutual Provident Society* 38 TC 492 and *Director General of Inland Revenue v EIL* (1950-1985) MSTC 256 followed.
 - (2) The concerned interest amount was not received by or paid to or derived by the branch from its clients on accounts of its business

on behalf of the appellant. Under art IV cl 1(a), tax may be imposed only on the income or profits derived by the branch in the course of its business. The fund provided by the head office was considered as a loan to its branch in Malaysia and interest was payable by the branch to the appellant on account of the loan. Thus, the payment by way of interest by the branch to the appellant constituted a business expense to the branch and a business income to the appellant which was exempted from tax because the appellant was not resident in Malaysia (see p 365A-E).

[Bahasa Malaysia summary]

Perayu menjalankan perniagaan bank di Singapura. Perayu menjalankan perniagaan bank di Malaysia menerusi sebuah cawangan di Kota Kinabalu, Sabah. Melalui ibu pejabat di Singapura, perayu telah membayar cukai berkenaan di Singapura atas faedah yang dikenakan atas jumlah yang disediakan kepada cawangan di Malaysia. Namun demikian, penentang juga telah mengeluarkan notis taksiran tambahan yang menghendaki bayaran dari perayu berhubung dengan faedah pendapatan yang sama. Perayu membantah terhadap cukai tambahan yang dikenakan ini atas faedah pendapatan dan merayu kepada Pesuruhjaya Khas. Perayu mendasarkan bantahan atas alasan bahawa caj faedah yang dikenakan atas cawangannya di Malaysia merupakan pembelanjaan perniagaan kepada cawangan dan suatu pendapatan perniagaan kepada ibu pejabat; dan bahawa disebabkan perkara IV dan XV Perintah Relief Pencukaaian Dua Kali (Singapura) 1968 ('Perintah 1968'), faedah yang diterima yang dikatakan tidak akan tertakluk kepada apa-apa cukai sebagai faedah pendapatan dan selanjutnya bahawa tiadanya kaitan ekonomik atau perdagangan antara ibu pejabat dan cawangan dalam peruntukan wang untuk mana cawangan dikehendaki bayar faedah atas dana yang diperuntukkan. Pesuruhjaya Khas menolak rayuan dan memutuskan bahawa faedah yang diterima oleh perayu adalah sebahagian daripada pendapatan perayu di Malaysia yang mana cukai Malaysia boleh dikenakan menurut perkara IV persetujuan dalam Jadual Perintah 1968. Maka rayuan dibawa ke mahkamah. Persoalan yang dikemukakan kepada mahkamah adalah sama ada atas fakta yang didapati oleh Pesuruhjaya Khas, keputusan mereka adalah betul dari segi undang-undang.

Diputuskan, membenarkan rayuan:

- (1) Melalui s 132(1) Akta Cukai Pendapatan 1967 ('Akta tersebut'), 'sebuah kedudukan prioriti dan kecemerlangan mesti diberikan kepada perjanjian' dalam Perintah 1968 berbanding dengan undang-undang domestik atau undang-undang perbandaran. Perundangan satu pihak mesti memberikan tempat kepada perjanjian yang menjadi undang-undang perbandaran. Sekiranya berlaku percanggahan, peruntukan Perintah 1968 harus mengatasi yang lain (lihat ms 364C-G); *Ostime (HM Inspector of Taxes) v Australian Mutual Provident Society* 38 TC 492 dan *Director General of Inland Revenue v EIL* (1950-1985) MSTC 256 diikuti.

- A (2) Amaun faedah yang berkenaan tidak diterima oleh atau dibayar kepada atau didapati oleh cawangan daripada klien atas akaun perniagaannya bagi pihak perayu. Di bawah perkara IV fasal 1(a), cukai hanya boleh dikenakan atas pendapatan atau keuntungan yang diperolehi cawangan ketika menjalankan perniagaan. Dana yang diperuntukkan oleh ibu pejabat dianggap sebagai suatu pinjaman kepada cawangannya di Malaysia dan faedah harus dibayar oleh cawangan kepada perayu dengan mengambil kira pinjaman itu. Maka, bayaran menerusi faedah oleh cawangan kepada perayu merupakan pembelanjaan perniagaan kepada cawangan dan suatu pendapatan perniagaan kepada perayu yang dikecualikan daripada cukai kerana perayu tidak menetap di Malaysia (lihat ms 365A-E).]
- B
- C

Notes

- D For cases on additional assessment, see 10 *Mallal's Digest* (4th Ed, 1996 Reissue) paras 1674-1691.

Cases referred to

- Director General of Inland Revenue v EIL* (1950-1985) MSTC 256 (folld)
- E *Ostime (HM Inspector of Taxes) v Australian Mutual Provident Society* 38 TC 492 (folld)

Legislation referred to

- Banking Act 1973
- Double Taxation Relief (Singapore) Order 1968
- F Income Tax Act 1967 s 132

Sandrasegaran Woodhull (Shearn Delamore & Co) for the appellant.
Salmah bte Kassim (Pegawai Undang-Undang, Jabatan Hasil Dalam Negeri, Malaysia) for the respondent.

- G *Cur Adv Vult*

Abdul Kadir Sulaiman J: The appellant, United Overseas Bank Ltd, is carrying on banking business in Singapore. Its business address during the basis years 1981 to 1985 was No 1, Bonham Street, Raffles Place, Singapore.

- H The appellant carries on the banking business in Malaysia through a branch in Kota Kinabalu, Sabah. In exercise of the powers conferred by s 132 of the Income Tax Act 1967 ('the Act'), the Minister, by PU518 of 1968 made the Double Taxation Relief (Singapore) Order 1968 ('the 1968 Order'). The schedule to the 1968 Order contains the agreement between the two governments for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income with a view to affording relief from double taxation in respect of taxpayers from both countries. By art XXI cl 1 of the agreement, it became effective as respect taxes from both countries from the year of assessment 1969 onwards. Section 132 of the Act states as follows:
- I

132 (1) If the Minister by statutory order declares that —

- (a) arrangements specified in the order have been made by the Government with the government of any territory outside Malaysia with a view of affording relief from double taxation in relation to tax under this Act and any foreign tax of that territory; and
- (b) it is expedient that those arrangements should have effect, then, so long as the order remains in force, those arrangements shall have effect in relation to tax under this Act notwithstanding anything in any written law.

Under the Banking Act 1973 ('the 1973 Act'), the appellant having a branch in Malaysia was required to maintain, inter alia, networking funds as part of the financial requirements and duties of a licensed bank here. Accordingly, for the relevant years of assessment 1982–1986, the head office in Singapore made available to its branch abovementioned sums required under the 1973 Act. The head office in Singapore charged interest on the sums made available to the branch in Malaysia for the purpose. The following were the amount of interest charged in respect of each basis year in respect of the sums made to the branch:

<u>Basis Year</u>	<u>Amount of Interest</u>
1981	\$ 35,233
1982	\$275,136
1983	\$338,991
1984	\$482,629
1985	\$394,015

Singapore income tax were paid by the head office on this interest income it received from the branch. However, the respondent also issued notices of additional assessment all dated 20 April 1987 requesting payment from the appellant in respect of the same interest income for the following years of assessment:

<u>Year of Assessment</u>	<u>Additional Tax Payable</u>
1982	\$ 15,855.10
1983	\$123,899.35
1984	\$152,547.75
1985	\$217,187.45
1986	\$169,094.36

The basis for the respondent in levying income tax in respect of the said interest was the proviso to para 33 of Schedule 6 which paragraph had been amended from time to time but for the purpose of this appeal the provisions applicable and effective from year of assessment 1982 states as follows:

- 33 Income of any person not resident in Malaysia for the basis year for a year assessment, in respect of interest derived from Malaysia (other than such interest accruing to a place of business in Malaysia of such person) and paid or credited by any person (whether the same person

A or not) carrying on the business of banking in Malaysia and licensed under the Banking Act 1973:

Provided that the exemption under this paragraph shall not apply to interest paid or credited on funds required for the purposes of maintaining networking funds as prescribed by the Central Bank of Malaysia in pursuance of s 14 of the Banking Act 1973.

B If the proviso is applied, it is clear that the said amount of interest paid by the branch to the respondent will be subject to tax because they are interest paid or credited on funds supplied by the appellant to the branch for the purpose of maintaining networking funds required under the 1973 Act. However, the appellant objected to the additional tax imposed by the
C respondent in relation to the amount of interest received by it and filed its appeal with the Special Commissioners. Before the Special Commissioners, the appellant put forward the following reasons for the objection. Firstly, that the interest charges imposed upon its branch in Malaysia constitutes a business expense to the branch and a business income to its head office.
D Secondly, by reason of arts IV and XV of the agreement contained in the 1968 Order, the said interest received would not be subject to any tax as interest income and further that there can be no economic or commercial link between the head office and the branch in the provisions of funds for which the branch is required to pay the interest on the fund provided. The Special Commissioners heard the appeal and made their deciding order on
E 29 October 1994 dismissing the appeal of the appellant and confirmed the additional assessment imposed by the respondent on the appellant in respect of the years of assessment 1982–1986. Briefly, the reason for the dismissal of the appeal was that having construed the provisions of arts XV and IV of the agreement in the 1968 Order, they came to the conclusion
F that the interest received by the appellant from its branch is part of the appellant's income in Malaysia on which Malaysian tax may be imposed in accordance with para 1(a) of art IV of the agreement.

Article IV cl 1(a) of the agreement states as follows:

G 1 (a) The income or profits of a Singapore enterprise shall not be taxable in Malaysia unless the enterprise carries on business in Malaysia through a permanent establishment situated in Malaysia. If the enterprise carries on business as aforesaid, tax may be imposed in Malaysia *on the income or profits of the enterprise* but only on so much thereof as *is derived by that permanent establishment in Malaysia*. (Emphasis added.)

H The appellant, being dissatisfied with the said decision of the Special Commissioners, by a notice dated 10 November required the Commissioners to state a case for the opinion of the High Court. Thus, by way of case stated this appeal is before this court now. The question posed by the Commissioners for this court's opinion is whether, on the facts
I found by them, their decision is correct in law.

As far as the facts are concerned, there is no dispute. It is a simple case of a foreign bank establishing a branch in Malaysia. By the law of

Malaysia, a banking institution is required to provide a networking fund. A
The branch of the appellant in Malaysia, being a banking institution, is
therefore required to provide this fund. This fund came from the appellant's
head office in Singapore. For the provision of the fund to its branch here,
the appellant in Singapore charged interest to be paid by the branch. For B
the purpose of income tax in Singapore, the appellant paid the tax upon
the said interest income received from its branch in Malaysia. On the other
hand, the respondent here wants a slice of the cake out of the said amount
of interest paid by the branch in Malaysia to the appellant in Singapore. Its
ground as stated earlier is based on the proviso to para 33 of Schedule 6
to the Act. The Special Commissioners in their case stated disagreed for
the reason that the provisions in the Act are being superseded by the 1968 C
Order as so provided by s 132 of the Act, when at p 6 of case stated the
Special Commissioners said that they are in complete agreement with the
appellant's 'primary contention that by reason of s 132(1) of the Act, a
place of priority and pre-eminence must be given to the agreement over
the domestic or municipal law, ie the Act'. In my view, they are right in so D
holding because the phrase 'any written law' found at the end of the said
section includes the Act itself which is a written law. The effect of the
conflict between — as in our case — the provisions of the Act and the
provisions as provided by the 1968 Order was considered by the House of
Lords in *Ostime (HM Inspector of Taxes) v Australian Mutual Provident*
Society 38 TC 492 as between the Income Tax Act of England and the E
Double Taxation Relief Agreement, where it was decided that the unilateral
legislation must give way to the agreement which becomes the municipal
law which, in our case, Malaysian law pursuant to s 132(1) of the Act. The
principle so stated in the case cited has been received and applied in
Malaysia in *Director General of Inland Revenue v EIL* (1950–1985) MSTC F
256. EIL from United Kingdom entered into agreement with a Malaysian
company to set up the EISB and EISB had paid money to EIL as managerial
fees. By s 2 of the Act, these payments are royalties which are subject to tax
but do not fall within the definition of royalty in the Double Taxation
Relief (United Kingdom) Order. It was held that because of s 132(1), in
the event of conflict, the provisions of the relief order should prevail. G

No doubt under the proviso to para 33 of Schedule 6 to the Act, such
interest paid or credited by the branch to the appellant on account of funds
provided by the appellant for the purpose of maintaining networking funds
required under the 1973 Act is not exempt from tax but in the light of the
conflict of the provisions of the proviso with art IV cl 1(a) of the agreement, H
providing otherwise, the provisions in the said clause of the article prevails.
Though art XVIII cl 1 states that the laws of Malaysia and Singapore shall
continue to govern the taxation of income derived from either country but
the clause itself excepted it where express provisions to the contrary is
made in the agreement. But art IV cl 1(a) made an exception by limiting
the income and profits of a Singapore enterprise to 'so much thereof as is I
derived by that permanent establishment in Malaysia'. Therefore, the
basis for the respondent imposing the additional tax on the appellant
relying on the proviso to para 33 thereof lacks merit.

- A However, in dismissing the appeal of the appellant, the Special Commissioners had misconstrued the provisions of art IV cl 1(a) of the agreement. It must not be lost sight of that the concerned interest amount was not received by, paid to or derived by the branch in Malaysia from its clients on account of its business on behalf of the appellant. Under the said
- B art IV cl 1(a), tax may be imposed only on the income or profits derived by the branch in the course of its business. It is logical because it is only that income or profits made by the branch in the course of its business here which constitute the income or profits of the appellant in Singapore. For whatever construction to be given to cl 1(b) of art IV, it is irrelevant for the Special Commissioners to consider because that cl 1(b) relates to a
- C Malaysian enterprise having a branch in Singapore, which is the converse. The fund provided by the appellant in Singapore is considered as a loan granted by it to its branch in Malaysia and interest is payable by the branch to the appellant on account of the loan so granted. It is therefore correct as so contended by the learned counsel for the appellant before me that the payments by way of interest by the branch to the appellant for the utilization
- D of funds provided by the appellant in Singapore to the branch in Malaysia constitutes a business expense of the branch and a business income to the appellant which even under the main provisions of para 33 of Schedule 6 to the Act is exempted from tax because the appellant was not resident in Malaysia and the said income is not such interest accruing to a business in
- E Malaysia.

- In the circumstances, the appeal by the appellant is allowed as the concerned interest is not the income or profits of the branch in the course of its business on behalf of the appellant. Pursuant to para 39(a) of Schedule 5 to the Act, I order that the additional assessments to which the
- F case relates be discharged and if paid be refunded to the appellant. Costs to the appellant.

Appeal allowed.

Reported by Zahid Taib

G

H

I